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White Collar Roundup - September 2016

Here, There, (Almost) Anywhere

The Second Circuit in *United States v. Lange* held that in securities-fraud prosecutions, "[v]enue is proper not only in the district where telephonic or electronic materially fraudulent communications were initiated, but also in the district where such communications were received." *Lange* involved a scheme in which people were solicited to invest under false pretenses in a precious-metals mining company. The company was run outside the Eastern District of New York (EDNY), but about 2 percent of the people on cold-call lists used by the schemers were residents of the EDNY. The defendants were ultimately indicted in the EDNY and convicted of securities fraud. They made motions for judgments of acquittal based on improper venue, and the district court granted their motions as to some counts. The government appealed. On appeal, the Second Circuit held that venue is proper in the district in which telephone calls are received, which included the EDNY in this case. The court reasoned that it was immaterial whether any of the people in the EDNY made an investment, because "[t]he making of an investment is not an element of the crime of securities fraud. Instead, the mere use of material misrepresentations to solicit investment is the 'essential element of the crime' in furtherance of securities fraud." Further, the court reasoned that venue was proper in the EDNY because the defendants knew that the cold-call list was a nationwide list and it was reasonably foreseeable that the list would include people in the EDNY. Finally, the court concluded that the government need not show that the defendants aided and abetted specific acts carried out by others in the EDNY for venue to be proper there. In securities-fraud prosecutions, venue is proper both in the district where the principal acts and where a defendant commits accessorial acts.

Backdating, Indeed!

About 10 years ago, the federal courts were replete with prosecutions for stock-option backdating. In its simplest terms, that is a practice in which stock-option grants, which are the rights to buy shares at a fixed price, are backdated to a day when the stock price was more favorable to the grantee. It runs afoul of the federal securities laws because it manipulates the stock to ensure that the grantee receives instant gains by choosing the starting price for the option. In 2006, the government was investigating Comverse Technology Inc. for backdating options and ultimately indicted those responsible. To avoid prosecution, the firm's chairman, Jacob "Kobi" Alexander, fled to Namibia, which is a nation in western Africa that has no formal extradition treaty with the United States. As reported here, just recently, some 10 years later, Alexander returned to the United States and pleaded guilty to the backdating charge. At the plea hearing, notwithstanding his decade abroad, Alexander had the chutzpah to seek release on bail pending sentencing. The judge denied the request out of hand, saying, "I wasn't born yesterday . . . [Alexander's] intelligence and his guile are clear indications that he can't be trusted." For the press release from the U.S. Attorney's Office for the Eastern District of New York, click here.

Law-enforcement Delight: Web-based Email and the Fourth Amendment

The U.S. Court of Appeals for the Seventh Circuit in *United States v. Caira* held that a person has no reasonable expectation of privacy in an Internet Protocol (IP) address for a web-based, commercial email service. As a result, law-enforcement officers do not need a warrant to obtain that information from the technology company that hosts the email account. Here, the Drug Enforcement Administration (DEA) was monitoring a website in Vietnam that sells sassafras oil, which is a chemical that can be used to make the illegal drug ecstasy. Someone emailed that website from the address "gslabs@hotmail.com" to purchase the oil. The DEA issued an administrative subpoena to Microsoft Corp., the owner of the Hotmail domain, asking for the IP address associated with the gslabs@hotmail.com email address. Microsoft provided it, which ultimately led the DEA to

Frank Caira, who was arrested and charged with drug trafficking. Caira moved to suppress the information provided to the DEA, arguing that its inquiry was a "search" under the Fourth Amendment that required a warrant. The district court denied the motion, and Caira pleaded guilty while reserving his right to appeal the suppression order. On appeal, the Seventh Circuit affirmed. That court relied on the "third-party doctrine," which holds that a person does not have a legitimate expectation of privacy in information that he or she voluntarily shares with third parties. Here, Caira shared his IP address with Microsoft. The court rejected his argument that the third-party doctrine "is ill suited to the digital age," the phrase employed by Justice Sonya Sotomayor in her concurring opinion in *United States v. Jones*, 132 S. Ct. 945 (2012), in which the Supreme Court required a warrant for the use of a GPS tracking device on an automobile.

The Case of the '"Fraudster Extraordinaire"'

In an opinion that reads like a comedy, the First Circuit in *United States v. Marino* took the defendant, Paul Marino, to task for his past fraudulent conduct when it upheld the district court's sentence for Marino's violations of supervised release. As explained in the opinion, Marino has engaged in fraud for years. For example, his initial conviction was for running an "elaborate scheme" in New York to fraudulently transfer people's property to an entity called "RYDPHO Holdings," which "apparently" stood for "Rip You Da Phuck Off." After pleading guilty to wire fraud in the U.S. District Court for the Southern District of New York, he was sentenced to a prison term to be followed by a term of supervised release. While on supervised release, however, Marino couldn't seem to escape his fraudulent ways. He contacted Dell Inc. to order computer equipment and then defrauded the company in two different ways. First, he ordered a monitor, which he then claimed had been stolen from his residence when being delivered, prompting Dell to send him a replacement. Upon receipt of that monitor, he contacted Dell to return it for a refund. When Dell received the return, it realized the monitor Marino returned was not the replacement monitor but the one that had allegedly been stolen from his porch. Oops. Second, he ordered additional computer equipment that he also sought to return to Dell. But instead of sending back the equipment, he filled the equipment boxes with rocks and concrete and sent those. Unsurprisingly, he was caught. When Marino was prosecuted for violating his supervised release, the district judge sentenced him to another year in prison along with time in a halfway house. He appealed to the First Circuit, which rejected his claims. In doing so, however, it admonished the government for failing to adequately explain why it relied on hearsay testimony during the revocation hearing instead of obtaining business records from Dell. The court warned, "We expect the government to have an explanation of this sort at the ready in future cases."

'"Fore!"' The Golf Channel Avoids a Near Miss

Back before Stanford International Bank Ltd. was revealed as a Ponzi scheme, it paid $5.9 million to the Golf Channel Inc. for a range of advertising aimed at recruiting investors. Of course, Stanford was a Ponzi scheme and ultimately collapsed. Thereafter, a receiver was appointed to claw back assets for repayment to its victims. The receiver sought repayment from the Golf Channel of the $5.9 million as an avoidable fraudulent transfer under Texas law. The Golf Channel moved for summary judgment, arguing that while the transfers might have been fraudulent under the statute, it had received the payments "in good faith and for a reasonably equivalent value." The district court granted summary judgment, and the receiver appealed. The Fifth Circuit reversed, reasoning that the advertising services were not for "value" because they "could only have depleted the value of the Stanford estate [by enticing more victims] and thus did not benefit Stanford's creditors." The Golf Channel petitioned for rehearing, and the Fifth Circuit vacated its opinion and certified the question to the Supreme Court of Texas. That court instructed that a transferee can provide "reasonably equivalent value" if it "(1) fully performed under a lawful, arm's-length contract for fair market value, (2) provided consideration that had objective value at the time of the transaction, and (3) made the exchange in the ordinary course of the transferee's business," even if the services are ultimately discovered to have been for a corrupt enterprise. Because the Golf Channel would have sold its advertising to someone else had Stanford not purchased it, the transfers were for "value," as viewed from a reasonable creditor's perspective. Accordingly, the Fifth Circuit in *Janvey v. Golf Channel Inc.* upheld the grant of summary judgment to the Golf Channel.

Cooperator Can't Be Penalized for Defendant's Acquittal

The Seventh Circuit in *United States v. Harrington* vacated and remanded the sentencing of a cooperating witness when the district judge appeared to have based the length of the sentence on the fact that the target of the cooperator's trial testimony was acquitted. Richard Harrington was a client of Chicago criminal defense lawyer Beau Brindley, who had successfully represented Harrington at his criminal trial. Ultimately, however, Harrington pleaded guilty to other charges, and District Judge Amy St. Eve of the U.S. District Court for the Northern District of Illinois sentenced him to 242 months of incarceration. Later, the U.S. Attorney's Office began investigating Brindley for suborning perjury of Harrington and other clients during their criminal trials. The government asked Harrington whether he would cooperate against Brindley. Harrington testified against Brindley at a bench trial, and Brindley was acquitted. The government filed a motion with Judge St. Eve, asking her to resentence Harrington with a 25 percent reduction. At the resentencing, Judge St. Eve noted that "Harrington's testimony didn't establish beyond a reasonable doubt that Mr. Brindley and his co-defendant had committed the crimes that they were charged with." She also noted that Harrington had lied at his own trial and had received "the benefit of the doubt during the original sentencing hearing" because she had not applied either an obstruction-of-justice enhancement or a two-level enhancement requested by the government. Judge St. Eve resentenced Harrington with a 14 percent reduction of his sentence, and he appealed. The Seventh Circuit puzzled over the result and took umbrage with the appearance "that [Judge St. Eve] thought that the size of any sentence reduction to which Harrington would be entitled would have to be a function not only of his effort on the government's behalf but also of his success." The Seventh Circuit vacated the sentence and remanded it to Judge St. Eve for resentencing.

SEC Disgorgement Isn't Barred by Lapsed Statute of Limitations

The Securities and Exchange Commission (SEC) brought an enforcement action against Charles Kokesh for misappropriating funds from SEC-registered business-development companies. After the jury returned a verdict for the SEC, the U.S. District Court for the District of New Mexico entered final judgment permanently enjoining Kokesh from violating the federal securities laws, ordering disgorgement of $34.9 million (along with prejudgment interest of $18.1 million) and imposing a civil penalty of $2.4 million. Kokesh appealed to the Tenth Circuit, arguing that the court's imposition of disgorgement and the injunction were barred by 28 U.S.C. § 2462, which sets a five-year statute of limitations for suits "for the enforcement of any civil fine, penalty, or forfeiture" by the United States. The Tenth Circuit in *SEC v. Kokesh* rejected Kokesh's claims and affirmed the judgment. The court first addressed the injunction, noting that it "fail[ed] to see how an order to obey the law is a penalty. Its purpose is not to penalize [the] Defendant; after all, everybody has a duty to obey the law." Therefore, the court concluded, § 2462 did not apply to the injunction imposed. As for the disgorgement, the court similarly concluded that it "is not a penalty under § 2462 because it is remedial." As a result, it rejected Kokesh's claims and affirmed the judgment.

New Pay-to-Play Prohibitions from the SEC

As of August 17, municipal advisors are subject to new pay-to-play regulations promulgated by the Municipal Securities Rulemaking Board (MSRB). The new regulations extend the MSRB's well-established municipal securities dealer pay-to-play rule to municipal advisors, including those acting as third-party solicitors. Consistent with the existing MSRB rule for dealers, the new regulations generally prohibit municipal advisors from engaging in municipal advisory business with municipal entities for two years if certain political contributions have been made to officials of those entities who can influence the award of business. To review the MSRB rules, click here. In other pay-to-play developments, the SEC approved the broker-dealer pay-to-play rule proposed by the Financial Industry Regulatory Authority (FINRA). FINRA Rule 2030 will prohibit broker-dealers from (1) soliciting a government entity (such as a public pension plan or other collective government fund) on behalf of an investment adviser, and (2) engaging in distribution activities with a government entity, for two years after certain contributions have been made by the broker-dealer to officials of the government entity. With the adoption of MSRB and FINRA rules, the last piece of the SEC's pay-to-play rule can be implemented. The SEC's pay-to-play rule prohibits investment advisers from compensating any third party for soliciting a government entity unless the solicitor is subject to either an MSRB or FINRA pay-to-play rule. Now that the MSRB and FINRA rules have been adopted, persons that solicit government entities on behalf of investment advisers are required to register with either the MSRB or FINRA.

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